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In the

Supreme Court of the United States

OCTOBER TERM, 1967

No. 956

LARRY D. HIBLER AND JUANITA HIBLER,
Petitioners,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

PETITION FOR WRIT OF CERTIORARI

To the United States Court of Appeals for the Fifth Circuit

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SUBJECT INDEX

Caption and Title 1

Reference to Lower Court Reports 1

Grounds on Which Jurisdiction is Invoked 1

Question Presented For Review 2

Statutory Provisions 2

Statement of the Case 2

Basis for Tax Court's Jurisdiction 4

Argument Amplifying Reasons Relied On For Allowance of Writ 4

Opinions of Lower Courts 9

Prayer 9

Certificate of Service 10

Appendix A-1

Cases	Page
Alstores Realty Corporation, 46 T.C. 363 (1966)	6
Anderson v. Helvering, 310 U.S. 404 (1940)	5, 6
McCulley Ashlock, 18 T.C. 405 (1952)	6
Commissioner v. Brown, 380 U.S. 563 (1965)	5, 6
Olin Bryant, 46 AFTR 848 (1966)	6, 7
Burton-Sutton Oil Co. v. Commissioner, 328 U.S. 25 (1946)	5
Burnet v. Harmel, 287 U.S. 103 (1932)	5
Thomas v. Perkins, 301 U.S. 655 (1937)	4, 5, 6, 7, 8
Commissioner v. P. G. Lake, Inc., 356 U.S. 260 (1958)	5, 8
Stratton's Independence v. Howbert, 231 U.S. 399 (1913)	5
Vermont Transit Co. v. Commissioner, 218 F. 2d 468	6
U. S. v. Witte, 306 F. 2d 81 (5th Cir. 1962)	6, 8

Announcements

T.I.R. 338 (September 15, 1961) 1961 Prentice-Hall Federal Taxes ¶54,908	5, 7

Other Publications

Ginsburg, "Dividing Income and Capital Appreciation Among Family Members," 25 N.Y.U. Inst. on Fed. Tax 671-673 (1967)	7
"The Present Status of the Border Line Between Capital, Ordinary, and Nontaxable Gains and Losses: A Panel Discussion," 25 N.Y.U. Inst. on Fed. Tax 613 at 636-638 (1967)	7
"Non-Depletable Property Doesn't Qualify for Tax Treatment Accorded ABC Transaction," Report Bulletin No. 5, ¶105.2 P-H Oil and Gas Taxes, 11-22-66	7
Bulletin of the Section of Taxation, American Bar Association, Vol. XX, No. 4 (July, 1967), pp. 144 and 262	7

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To the United States Court of Appeals for the Fifth Circuit

To the Honorable Earl Warren, Chief Justice of the United States, and the Associate Justices of the Supreme Court of the United States.

REFERENCE TO LOWER COURT REPORTS

The per curiam opinion of the Court of Appeals for the Fifth Circuit is reported in .... F. 2d ....

The opinion of the Tax Court is reported in 46 T. C. 633.

GROUNDS ON WHICH JURISDICTION IS INVOKED

1. The date of the judgment sought to be reviewed, and the date of its entry, is November 2, 1967.

2. Jurisdiction to review the judgment in question is conferred by Section 1254(1) of Title 28 of the United States Code.

QUESTION PRESENTED FOR REVIEW

The question presented for review is whether in the sale of an insurance expiration list there was such a reservation by the seller as to cause a part of the post-sale income therefrom to be taxed to the seller and not to the buyer.

STATUTORY PROVISION

The only statutory provision involved is Subsection 61(a) of the Internal Revenue Code of 1954 (also Subsection 61(a) of Title 26 of the United States Code). It reads in pertinent part as follows:

> "(a) General definition.—Except as otherwise provided in this subtitle, gross income means all income from whatever source derived, including (but not limited to) the following items:
>
> (1) Compensation for services, including fees, commissions, and similar items;
>
> (2) Gross income derived from business;"

STATEMENT OF THE CASE

All facts were stiplated. Summarized, the material facts are as follows:

On January 24, 1962, Walker sold to Hibler the expiration list and certain tangible personalty used in his fire, casualty and fidelity insurance agency. Two documents were executed, a contract and a bill of sale. (These docu-

ments are set out in the opinion of the Tax Court appended.) The bill of sale recited a consideration of $20,000.00 cash and a reservation of 50% of the commissions upon renewal of policies in the expiration list until such 50% totaled $70,000.00. The contract repeatedly and consistently referred to the 50% of commissions as having been reserved from the sale. It provided that Hibler would serve as a trustee in receiving and remitting Walker's share to Standard Accident Insurance Company for Walker's benefit. Hibler's only obligations were to exercise reasonable diligence to renew the policies on the expiration list and to use reasonable efforts to prevent the loss of business and to remit the proceeds of the interest reserved by Walker. Hibler could not sell without the consent of Walker and Standard. Aside from the above obligations Hibler was not liable for the payment of the $70,000.00. Walker had no right to repossess or sell the assets so conveyed unless Hibler defaulted in the performance of the above obligations.

Both documents were prepared by an attorney for Standard. Hibler was not represented in the transaction by any attorney.

Hibler's post-sale services were necessary to produce revenue from the expiration list.

The 50% commissions paid to Walker pursuant to the above documents amounted to $6,196.49 in 1962 and $5,226.50 in 1963. Hibler did not pay income tax on these amounts.

The respondent determined that Hibler should have paid tax on these amounts. The Tax Court sustained the re-

spondent, and the Fifth Circuit Court of Appeals affirmed the Tax Court per curiam.

BASIS FOR TAX COURT'S JURISDICTION

Jurisdiction was conferred upon the Tax Court by sections 7442 and 6213 of the Internal Revenue Code of 1954 (section 7442 and 6213 of Title 26 of the United States Code).

ARGUMENT AMPLIFYING REASONS RELIED ON FOR ALLOWANCE OF WRIT

The Tax Court, as affirmed per curiam by the Fifth Circuit, has decided a federal question in a way in conflict with applicable decisions of this Court. The issue involved is of national interest and importance.

The issue in the case essentially is whether one who sells a non-depletable asset and reserves from the sale a portion of the post-sale income therefrom is taxable on such income, or whether the buyer is taxable thereon.

This precise issue, as it applies to minerals, was presented to the Supreme Court in *Thomas v. Perkins*, 301 U.S. 655 (1937). There A conveyed undeveloped leases to taxpayer for cash and reserved $395,000 to be paid only out of one-fourth of oil if, as and when produced. Oil could be produced only through the development and operational activities of taxpayer or his transferees. The Court held taxpayer could exclude such one-fourth from his income.

Based upon such case, the Internal Revenue Service has long issued rulings to similar purchasers of mineral interests.

T.L.R. 338, (September 15, 1961), 1961 Prentice-Hall Federal Taxes ¶54,908.

The lower courts have refused to apply *Thomas v. Perkins* to the case at hand solely because the former dealt with depletable natural resources.

The treating of the income of depletable assets differently from that of non-depletable assets is in conflict with applicable decisions of this Court. *Stratton's Independence v. Howbert*, 231 U.S. 399 (1913), holding that the production and sale of minerals was not a mere conversion of capital from one form to another, but was an income producing operation similar to manufacturing; *Burnet v. Harmel*, 287 U.S. 103 (1932), and *Anderson v. Helvering*, 310 U.S. 404 (1940) stating that mining operations resemble a manufacturing business carried on by the use of the soil; *Burton-Sutton Oil Co. v. Commissioner*, 328 U.S. 25 (1946), stating that royalty payments under mineral leases are income to the lessor, like payments of rent; and *Commissioner v. Brown*, 380 U.S. 563 (1965), stating that extracting natural resources is viewed as an income-producing operation and not as a conversion of capital investment.

The decision of this Court in *Commissioner v. P. G. Lake, Inc.*, 356 U.S. 260 (1958), illustrates that the same rules of income recognition apply to minerals as to non-minerals. The lower courts had unanimously relied on the well established mineral doctrines of economic interest and oil in place to confer capital gains treatment on an oil payment carve out. This Court reversed by unanimous decision.

The lower courts in this case justified their distinction between minerals and non-minerals on this Court's distinction of *Thomas v. Perkins* in the case of *Commissioner v. Brown, supra. Commissioner v. Brown* is not in point.[1]

This case represents, we believe, the first attempt by any court to limit *Thomas v. Perkins* to minerals. Other courts have at least assumed that it was not so limited.[2] Clearly if it were not so limited, the seller would have effectively reserved income in the instant case. The documents in this case could hardly more clearly have expressed the intent of the parties that the seller reserve income.

The issue in this case is unquestionably of national interest.[3]

---

[1] The issue there was whether there was a sale. The question of whether there was a reservation was not involved. Cf. *U.S. v. Witte*, 306 F. 2d 81 (5th Cir. 1962). *Brown* first distinguished *Perkins* because of the policy of the tax law to allow the taxpayer to realize on appreciated values at capital gains rates. Such distinction had no relation to whether minerals were involved in *Perkins* or not. *Brown* simply did not involve a reservation from an admitted sale. The "peculiar character" of minerals, mentioned in *Brown*, has been recognized only for the purpose of allowing a deduction for depletion. *Brown* next distinguished *Perkins* by pointing out the limitation on *Perkins* announced by *Anderson v. Helvering, supra.* The *Anderson v. Helvering* limitation obviously applied in *Brown.* On the contrary, such limitation does not apply to the instant case. Since Hibler's only obligation was to use his best efforts and to remit Walker's portion, as a matter of substance Walker had to look solely to production under the expiration list for the satisfaction of his reserved interest. (By way of comparison, the possibility of receiving compensation for damages for breach of the universal covenant to reasonably develop in an oil and gas lease has never brought the *Anderson v. Helvering* limitation into force.)

[2] *Vermont Transit Co. v. Commissioner*, 218 F. 2d 468 at 469 (2d Cir. 1955), cert. den. 349 U. S. 945 (1955); McCulley Ashlock, 18 T. C. 405 at 412 (1952); *Alstores Realty Corporation*, 46 T. C. 363 at 372 (1966).

[3] The same Tax Court judge who decided *Hibler* subsequently thereto handed down the decision in *Olin Bryant*, 46 T. C. 848 (1966), now on appeal to the Fifth Circuit. Such case involved the same issue and the court cited and followed its own holding in *Hibler.*

(Footnote Continued on Following Page)

It is common knowledge, *T. I. R. 338, supra,* that the Internal Revenue Service issues rulings applying the reservation of income principles of *Thomas v. Perkins* to minerals. Undoubtedly these approved transactions, both in number

(Footnote Continued From Preceding Page)

Counsel herein (who also represents the taxpayers in *Bryant*) has received inquiries upon this issue from New York, California, Pennsylvania and Texas. The *Bryant* case has been specially commented upon in a nation wide tax service ("Non-Depletable Property Doesn't Qualify for Tax Treatment Accorded ABC Transaction", Report Bulletin No. 5. ¶ 105.2, P-H Oil and Gas Taxes, 11-22-66, emphasizing that mineral income is to be accorded different treatment) and in a leading tax institute (Ginsburg, "Dividing Income and Capital Appreciation Among Family Members," 25 N.Y.U. Inst. on Fed. Tax 671-673 [1967]) and in the Bulletin of the Section of Taxation, American Bar Association, Vol. XX, No. 4 (July, 1967), pp. 144 and 262.

Hibler and *Bryant* have both been discussed by a leading tax panel. "The Present Situs of the Border Line Between Capital, Ordinary, and Nontaxable Gains and Losses: A Panel Discussion," 25 N.Y.U. Inst. on Fed. Tax 613 at 636-638 (1967).

The issue has also been the subject of Congressional debate. The following is quoted from footnote 7 of the Tax Court's opinion in *Olin Bryant*:

> "See also the recent remarks by Senator Gore of Tennessee where, in resisting the issuance of a favorable revenue ruling involving an ABC acquisition of depletable mineral interests other than oil and gas, he referred to the 'notorious ABC scheme' which is 'a sophisticated tax gimmick.' See 113 Cong. Rec. 12080-12083 (June 8, 1966), 18146-18147 (Aug. 11, 1966), 18685 (Aug. 16, 1966). 'Heretofore, the ABC transaction has been largely confined to oil and gas, which are, of course, favored industries. But I see no reason to compound inequity by allowing the ABC transaction to spread to other industries. * * * The ABC transaction is a tax dodge, pure and simple. Taxation is the principal reason for setting it up,' 112 Cong. Rec. 12081 (June 8, 1966). See also S. 3719, 89th Cong. 2d Sess. (1966), introduced by Senator Gore and referred to the Senate Committee on Finance on Aug. 11, 1966, which would make the ABC transaction less profitable, especially outside of the oil and gas industry.
>
> "We simply point to this information as showing some resistance to the extension of the ABC doctrine, not only outside of the mining industry generally, but also outside of the oil and gas industry itself."

and in dollar volume, are very large in amount. While only the Service would know, upon information available to petitioners it seems reasonable to assume that this represents one of the larger areas of ruling by the national office.

It works a major inequity upon a large segment of the American society to apply the general reservation of income principles announced by *Thomas v. Perkins* only to those who have their income producing investments in minerals. As discussed above, this Court has consistently held that income from minerals is treated as operating income, just as is income from other investments. Thus, absent legislation, there is no basic justification for establishing one rule for the recognition of one type of operating income (minerals) and a different rule for another (non-minerals). *Commissioner v. P. G. Lake, Inc., supra.*

Upon the merits, petitioners would show that there is economic justification for applying the *Thomas v. Perkins* reservation of income principle to both minerals and non-minerals. It is, of course, obvious that these principles sometimes work to a taxpayer's disadvantage. *U. S. v. Witte, supra.*

The importance of this issue is that a fundamental general principle of tax law regarding recognition of income should be uniformly applied to operating income from all types of investments.

OPINIONS OF LOWER COURTS

The per curiam opinion of the Fifth Circuit Court of Appeals is appended hereto. (See Appendix)

The opinion of the Tax Court is set out on pages 5 through 24, both inclusive, of the record printed for the use of the court below, nine copies of which are filed herewith under paragraph 4 of Rule 21.

Wherefore, premises considered, petitioners pray that this Court grant this their petition for Writ of Certiorari to the Court of Appeals for the Fifth Circuit.

Respectfully submitted,

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CERTIFICATE OF SERVICE

The undersigned attorney for petitioners has on this 15 day of Dec, 1967, mailed (by depositing same in the United States mail, with first class postage prepaid) three copies of the foregoing petition addressed to Solicitor General, Department of Justice, Washington, D. C. 20530 and three such copies addressed to Honorable Mitchell Rogovin, Assistant Attorney General, Tax Division, United States Department of Justice, Washington, D. C. 20530.

Bob Huff

BOB HUFF

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11

APPENDIX

In the

UNITED STATES COURT OF APPEALS

For the Fifth Circuit

No. 24318

LARRY D. HIBLER AND JUANITA HIBLER,
Petitioners,

versus

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

Petition for Review of a Decision of the Tax Court (Texas Case).

(November 2, 1967.)

Before JONES and GODBOLD, Circuit Judges, and SCOTT, District Judge.

PER CURIAM: The facts giving rise to this appeal and the controlling principles of law are set forth in the opinion of the Tax Court. *Hibler v. Commissioner*, 46 T.C. 663. We are in agreement with its decision. The appellant on argument stresses the opinion of this Court in *Moberg v. Commissioner*, 365 F. 2d 337, which was decided too late for consideration by the Tax Court. The facts of the *Moberg* case distinguished it from this case and make inapplicable the rule there announced. The decision of the Tax Court is AFFIRMED.

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SUPPLEMENTAL APPENDIX TO THE PETITION FOR WRIT OF CERTIORARI

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SUPPLEMENTAL APPENDIX

Opinion of the Tax Court of the United States

(Number and title omitted) (Filed: August 23, 1966)

On January 24, 1962, petitioner purchased all assets used in a fire and casualty insurance agency, including equipment, records and expiration lists. In addition to a cash payment of $20,000, the bill of sale and a simultaneously executed contract provided that petitioner would pay to the seller or on his behalf 50 percent of the commission income received from the renewal business reflected on the seller's books at the time of the sale until $70,000 was received. Pursuant to the contract, petitioner paid the seller certain amounts in 1962 and 1963. Petitioner included such amounts in his gross income and deducted the same amount as business expenses. *Held,* (1) that such amounts are not excludable from petitioner's gross income and (2) that the payments are not deductible by petitioner as ordinary and necessary business expenses since they represented part of the cost of acquiring the insurance expiration lists.

Edward R. Smith and *William Norton Baker,* for the petitioners. *Sidney B. Williams,* for the respondent.

OPINION

DAWSON, *Judge*: Respondent determined a deficiency in income tax against petitioners for the years 1962 and 1963 in the amounts of $1,263.84 and $2,065.92, respectively.

The issues for decision are whether amounts paid as "commissions" by petitioner Larry D. Hibler to G. O. Walker, pursuant to an agreement for the purchase of certain properties of the Walker Insurance Agency, are includable in petitioner's gross income and, if so, whether they are deductible as ordinary and necessary business expenses.

All of the facts have been stipulated and are adopted as our findings.

Larry D. Hibler (hereafter called petitioner) and Juanita Hibler are husband and wife who reside in Lubbock, Texas. They filed their Federal joint income tax returns for 1962 and 1963 with the district director of internal revenue at Dallas, Texas. Juanita Hibler is a party to this proceeding only because she signed the joint returns.

On January 24, 1962, petitioner purchased certain properties from G. O. Walker which had been used by Walker in the operation of the G. O. Walker & Company Insurance Agency. Relevant portions of the bill of sale are as follows:

> THAT I, G. O. Walker, of the County of Lubbock, State of Texas, for and in consideration of the sum of Twenty Thousand and No/100 ($20,000) Dollars, cash, to me in hand paid by Larry D. Hibler, of Lubbock County, Texas, receipt of which is hereby acknowledged, have bargained, sold and delivered, and by these presents do bargain, sell and deliver unto the said Larry D. Hibler the following described personal property situated in Lubbock County, Texas, to wit:
>
> (1) All furniture, fixtures and equipment located in the insurance agency heretofore operated under

the name of G. O. Walker & Company in the City of Lubbock, Lubbock County, Texas.

(2) All records and expirations of insurance of G. O. Walker & Company as of February 1, 1962.

It is specifically understood and agreed that this sale does not include the right to operate the above described agency under the name of G. O. Walker & Company, does not include the accounts receivable and notes belonging to the undersigned, and does not include any automotive equipment. It is further specifically understood and agreed that the above named purchaser does not assume or agree to pay any of the debts owing by the said agency or by the undersigned.

There is reserved by the undersigned, G. O. Walker, the right to receive fifty per cent (50%) of the commissions paid to the above named purchaser, his heirs or assigns, by reason of coverage issued in renewal of business reflected on the books of G. O. Walker & Company as of February 1, 1962, until fifty per cent (50%) of such renewal commissions shall have totaled the sum of Seventy Thousand and No/100 ($70,000.00) Dollars, at which time all interest of the said G. O. Walker, his heirs or assigns, in such renewal commissions shall terminate. In connection with this provision, any policies or bonds which have already been issued but which become effective after February 1, 1962, shall be considered new business or renewal business, depending upon whether or not such policies or bonds were issued in renewal of coverage which was in effect on said date.

Simultaneous with this purchase, the petitioner, G. O. Walker and Standard Accident Insurance Company entered into an agreement pertaining to the payment of policy renewal commissions and meeting the $70,000 maximum obligation in the event of a sale of part of the agency or a

breach of obligation by petitioner. This agreement provides, in pertinent part, as follows:

> WHEREAS, Walker has this day sold and conveyed to Hibler certain assets pertaining to the business heretofore operated by Walker under the name of G. O. Walker & Company, and there was reserved from said sale fifty percent (50%) of the commissions to be paid on insurance policies and bonds issued in renewal of business reflected on the books of G. O. Walker & Company as of February 1, 1962, until the proceeds of the reserved interest total $70,000.00; and
>
> * * * * *
>
> 1.
>
> Hibler shall pay, promptly after the first of each month, to Standard Accident Insurance Company, fifty percent (50%) of the commissions received by him on all business written in renewal of business reflected by the books of G. O. Walker & Company on February 1, 1962. Standard shall, promptly upon receipt of such payment, remit forty percent (40%) of such payment to Walker and apply the other sixty percent (60%) of such payment to the reduction of Walker's indebtedness to it.
>
> 2.
>
> Hibler agrees that in receiving the renewal commissions he will act as trustee for Walker to the extent of fifty percent (50%) thereof, and will remit Walker's share as promptly as possible to Standard, and Standard's receipt for such payment, or endorsement on Hibler's check, shall be fully binding on Walker and shall protect Hibler from any claim on the part of Walker for the amount of such payment.
>
> 3.
>
> Hibler agrees that he will exercise reasonable diligence to renew the business reflected on the books of

G. O. Walker & Company as of February 1, 1962, and will use all reasonable efforts to prevent the loss of such business and will diligently and in good faith service said accounts, to the end that the interest in said renewal commissions reserved by Walker shall, as promptly as possible, total the said sum of $70,000.00.

* * * * *

5.

Hibler shall not sell all or a material part of the insurance agency which he proposes to conduct, nor will he deliver possession of the records or expirations thereof to any other party, without the written consent of Walker, his executors, heirs or administrators, and of Standard. This provision shall be construed as prohibiting any transfer of any nature involving a substantial part of the furniture, fixtures and equipment sold by Walker to Hibler, as well as any transactions involving the transfer of possession of the books, records and expirations of the agency to be conducted by Hibler, without the consent aforesaid.

6.

If Hibler should default in the performance of any obligation resting upon him hereunder, and such default should continue for five (5) days after notice thereof has been served upon Hibler by Walker or by Standard, either Walker or Standard shall be entitled to take immediate possession of the records and expirations of the agency being operated by Hibler, and of the furniture, fixtures and equipment aforesaid, and either of said parties may thereupon sell such books, records and expirations, furniture, fixtures and equipment, to any purchaser, upon any price and terms which they, or either of them, may deem advisable, and apply the proceeds of such sale to the retirement of any unpaid balance of the seventy thousand dollar interest in said renewals reserved by Walker in the pro-

portions of 60% to Standard and 40% to Walker, and if the proceeds of such sale should exceed the amount necessary to accomplish said purpose, such excess proceeds shall be returned to Hibler.

7.

Nothing herein contained shall be construed as imposing upon Hibler any liability to pay said sum of $70,000.00; the obligation of Hibler with respect thereto is limited to the obligation to exercise the diligence aforesaid in connection with the collection and receipt of the above mentioned renewal commissions and to remit the proceeds of the interest reserved by Walker as herein provided.

8.

When and if Walker's indebtedness to Standard shall have been paid, either out of the aforesaid portion of the interest in renewal commissions reserved by Walker or otherwise, Standard shall reassign to Walker, his heirs or assigns, the remaining balance of such reserved interest and shall promptly notify Hibler of such reassignment.

Both agreements were prepared by an attorney for Standard Accident Insurance Company. He billed his services to that company. Petitioner paid no part of his fee and was not represented in the transaction by any attorney.

Of the $20,000 paid at the time of sale, petitioner allocated $10,000 to furniture, fixtures, equipment, and other depreciable assets. The remainder was allocated to an account styled "Prepaid Commissions" which petitioner amortized, although half of it was later disallowed by respondent.

G. O. Walker & Company dealt exclusively in fire, casualty and fidelity insurance. Unlike life insurance, these types

of insurance policies are not "automatically renewed" and must be solicited again after a certain period of time. G. O. Walker & Company had gross premium income of $196,433.82 for 1959, $213,598.28 in 1960, and $203,044.18 in 1961. It is the insurance expirations on these policies which were transferred to petitioner.

The following is a schedule of the commissions on policy renewals paid on Walker's behalf, pursuant to these agreements, during the years 1962 through 1965, as well as a summary of gross premium income received by the Larry D. Hibler Agency on the renewal of these expirations:

Year	*50% Commissions*	*Gross Premium Income*
1962	$6,196.49	$62,604.45
1963	5,226.50	58,020.08
1964	4,292.22	39,991.05
1965	4,015.81	43,521.17

The amounts of $6,196.49 and $5,226.50 for the years 1962 and 1963, respectively, paid by petitioner on Walker's behalf, were reported as taxable income in such years by petitioner. He then deducted them as commission expenses. The effect of such inclusion and offsetting deduction was to leave taxable income as if such amounts had neither been reported as income nor deducted as expense.

Respondent disallowed the deductions claimed for the payments made to Walker in 1962 and 1963 with the following explanation:

> (c) It is determined that the amount * * * claimed as a deduction for commissions paid expenses constitutes a capital expenditure for the purchase of intangi-

> ble assets which have an indeterminate life rather than an ordinary and necessary business expense and the amount * * * is therefore disallowed.

Petitioner concedes that if respondent correctly determined that the amounts paid on behalf of G. O. Walker constitute expenditures for capital assets, then no part of those expenditures is amortizable or deductible.

In addition to respondent's determination with respect to the amounts of $6,196.49 and $5,226.50 paid Walker in 1962 and 1963, the respondent also disallowed $885.20 and $746.60 of the commission expense deduction claimed for the years 1962 and 1963. Pursuant to an agreement reached by the parties, petitioners are entitled to deductions for 50 percent of the latter amount, i.e., $442.60 for 1962 and $373.30 for 1963.

Petitioner contends that the amounts in question belonged to Walker and therefore were not income to him. He points to the language of the agreement and emphasizes that because it was written by Walker's assignee it reflects the seller's intent. He argues that Walker reserved an income interest in the policy renewal commissions and was the person who received the beneficial interest from the commissions since petitioner was under a legal obligation to pay them to him. From this he maintains that such amounts were income only to Walker and that petitioner was merely trustee for him when he received and distributed them.

The countervailing contention of respondent is that amounts paid to Walker out of Commissions constitute part of the purchase price of a capital asset, viz., the expiration

lists, having an indeterminate useful life and, consequently, are not deductible expenditures. Respondent claims that the commissions paid to Walker were petitioner's income because they were earned through his efforts and because the benefits of such income inured to him.

The parties agree that there was a sale, but disagree as to what was sold. They are also in agreement that economic substance prevails over form, *Higgins v. Smith*, 308 U.S. 473 (1940), and that tax consequences are not determined solely by the mechanical means used to transfer legal title to property, *Commissioner v. Court Holding Company*, 324 U.S. 331 (1945). It is settled, too, that customer lists of fire and casualty insurance constitute capital assets for tax purposes. *Commissioner v. Killian*, 314 F. 2d 852 (C.A. 5, 1963); and *George J. Aitken*, 35 T.C. 227, 229 (1961).

As we view it, there was a sale to petitioner of all ownership in the insurance expirations when the agreements were executed. The plain language of the agreements shows that a complete transfer of the insurance expirations was intended. The bill of sale states that Walker "bargained, sold and delivered" to petitioner "all records and expirations of insurance of G. O. Walker & Company as of February 1, 1962." There is no mention of expirations in the list of items being withheld from the sale. Walker did reserve a right to be paid "commissions" to be earned by petitioner. However, petitioner bore all the risks and burdens of ownership from the date of sale. See *McCulley Ashlock*, 18 T.C. 405, 411 (1952): *Alstores Realty Corporation*, 46 T.C. No. 34 (June 15, 1966). See also *2 Lexington Avenue Corp.*, 26 T.C.

816 (1956), where this Court held that rents which accrued between the contract date and the closing date remained taxable to the seller of the property despite the fact that the buyer's purchase price was credited with the amount of the rents. Citing *Helvering v. Horst*, 311 U.S. 112 (1940), we said that the rents were "earned" by the seller during such period because the greater bundle of rights and incidents of ownership remained with him.

It is true that petitioner was obligated to service the renewal accounts; that he could not deliver possession of the expirations to another party without the consent of Walker and his assignee; and that, in case of default, Walker was entitled to immediate possession of the expirations, including the right to sell them and apply the proceeds to the "unpaid balance of the seventy thousand dollar interest in said renewals." But, except for his right to receive 50 percent of the "commissions" earned on the expiration renewals, what Walker actually had was a security interest. His status was that of a creditor with protection for an outstanding obligation, and not that of an owner of an economic interest in the property sold.

It is well established that income is taxed to the one who earns it or otherwise creates the right to receive it and to enjoy the benefits of it when paid. Moreover, income arising from property is taxable to the owner thereof. *Lucas v. Earl*, 281 U.S. 111 (1930); *Helvering v. Horst*, *supra;* and *Helvering v. Eubank*, 311 U.S. 122 (1940), involving commissions on life insurance policy renewals. Since policies of fire, casualty and fidelity insurance, unlike life

insurance, are not automatically renewed, and since Walker withdrew from active participation as an insurance agent at the date of sale, the petitioner became solely responsible for operating the business and generating income from renewals. It was he who had the control and benefits of ownership in the expiration lists. It was he who had to resell the insurance to former customers of Walker when the policies expired before there were any commissions. In terms of both labor expended and property owned, it was he who earned *all* the commission income.

Petitioner's objective in entering into the agreements was to acquire the benefit of the established insurance business of Walker. In substance, as we view the situation, petitioner paid Walker $20,000 cash for the insurance business at once, and obligated himself to make additional payments out of renewal commissions up to a maximum of $70,000 depending on how profitable the renewal business might turn out to be. That such was the intent of the parties is confirmed, in part, by the provision in paragraph 6 of the agreement that upon default in making these payments Walker would be entitled to take "immediate possession of the records and expirations," sell them, and apply the proceeds of sale to the unpaid balance of $70,000.

We think this case falls within the ambit and rationale of our opinion in *Vermont Transit Co.*, 19 T.C. 1040 (1953), affd. 218 F. 2d 468 (C.A. 2, 1955), certiorari denied 349 U.S. 945 (1955). In that case the buyer and seller were unable to agree upon the value of a bus franchise. In consideration of the transfer of the franchise, the buyer agreed

to and did pay the seller $3,500 and a percentage of the net income above operating costs. Rejecting the buyer's contention that the seller had reserved and retained a percentage interest in the net income, we concluded that the payment of a percentage or net income was simply a convenient method of setting the purchase price for the franchise and that since such net income represented the purchase price of the franchise, it was taxable to the buyer. In so holding, we said (19 T.C. at pp. 1044-1045):

> Here, income actually earned and received by petitioner, by operating its own buses with its own employees pursuant to its newly acquired operating rights, was being paid into escrow in discharge of the obligation which petitioner assumed in order to acquire those rights. That petitioner has thus received benefit from such income seems clear. The tax consequences should not change merely because the payments for the rights were deferred and uncertain at the time the transfer took place. * * *
>
> The many factors that enter into making any business profitable all served to produce the earnings here. Frontier, by contracting for a part of those earnings was contracting for a part of petitioner's management, maintenance facilities, and the like, and perhaps even good will. * * *
>
> The fares collected by the petitioner in the operation of the franchises became part of its gross income at that time. It makes no difference that the petitioner had agreed to pay them into escrow so that the purchase price for the operating rights could be segregated from its other income. The status of the money for tax purposes did not change because it was agreed that it be devoted to a particular purpose. Cf. *Lucas v. Earl*, 281 U.S. 111.

We have carefully considered the many cases cited by petitioner relating to the general rule that a seller may reserve income in property sold. But we believe all of them are either factually or legally distinguishable from the instant case. Where post-sale income is applied against the purchase price, the courts have had to decide, on the facts of each case, whether the seller reserved to himself and retained post-sale income. With such reservation and retention, the seller has been held taxable. Without such reservation and retention, the buyer has been held taxable on the theory that such income was either actually or constructively received by the buyer and applied against the purchase price. Sometimes the line of demarcation between the decided cases has been exceedingly thin or shadowy, and no single factor has been used by the courts in reaching their determinations. No doubt an inordinate amount of judicial time has been devoted to solving the problems arising from "reservation of income" cases in an effort to reach a general consensus of what the law is, not to mention what it ought to be. However, out of the decisional law there have evolved some seemingly conflicting views which are difficult to reconcile.

Cases like *Thomas v. Perkins*, 301 U.S. 655 (1937) and *United States v. Witte*, 306 F. 2d 81 (C.A. 5, 1962), involving reserved economic interests in oil, gas, sand or gravel, are disparate and reliance on them is misplaced. They deal with depletable natural resources. They do not have "unlimited sweep" and their applicability has been severely limited by the Supreme Court. See *Commissioner v. Brown*, 380 U.S. 563, 575-576 (1965), and *Anderson v. Helvering*, 310 U.S. 404, 412 (1940). Therefore, we are unwilling to extend their

rationale to cover an attempted reservation of a specified amount of future income earned by this petitioner in selling fire and casualty insurance renewals.

McCulley Ashlock, supra, involved the sale of realty subject to an existing lease, the rentals from which were payable to the seller in diminution of the purchase price. We held the seller taxable on the rent from the lease because he had carved out his interest in the post-sale income from the fee and had sold the remainder of the fee to the buyer. The factors which indicated the seller's retention of control and ownership of an interest were: (1) The seller was to pay during the term of the lease all property taxes, including insurance premiums, and all normal maintenance expenses; (2) he was to bear all losses in the event of temporary damage or destruction to the building; (3) in case of complete destruction of the building the buyer had the option to rebuild or pay the seller for the unpaid rent; and (4) no debtor-creditor relationship was created. In *Ashlock* the seller expressly reserved the right to possession and control during the period he was to receive the rents and thus had beneficial ownership during such period. By contract, the petitioner in this case had possession and control of the business when the fire and casualty insurance renewal commissions were earned and a percentage of them paid over to Walker. Thus the *Ashlock* opinion supports, rather than denigrates, our conclusion here. Cf. *Alstores Realty Corporation, supra.*

Ruth W. Collins, 14 T.C. 301 (1950), and *Central Life Assur. Soc. Mut. v. Commissioner,* 51 F. 2d 939 (C.A. 8,

1931), are distinguishable for the same reasons set forth in *Vermont Transit Co. supra.* Furthermore, it is clear from the facts in *Collins* that the seller continued to work regularly in the department store after selling her interest in the business to her son; hence, her efforts helped in some degree to produce the business income and she did have a beneficial interest therein. That is quite different from what happened in this case. Walker did nothing after the sale was consummated. There would have been no post-sale income if petitioner had not contacted Walker's former customers and written the new contracts for the fire and casualty insurance.

Neither has the petitioner established that the payments here involved were made pursuant to an arrangement sometimes entered into by professional men to share fees received from clients referred to one by another. Cf. *Mark D. Eagleton,* 35 B.T.A. 551 (1937), affirmed on other issues 97 F. 2d 62 (C.A. 8, 1938). Nor do we consider apposite our decisions in *May T. Hrobon,* 41 T.C. 476 (1964), where the taxpayer transferred to her former husband all her right, title and interest in a trust life estate, but by the agreement retained 60 percent of the net distributions of the trust for herself; and *Willard S. Hemingway,* 44 T.C. 96 (1965), where the seller retained a life interest in dividends to be paid by a company with respect to stock she sold to her brother. While *Fellows Sales Company v. United States,* 200 F. Supp. 347 (D.C.S.D., 1961), is admittedly close to this case in some respects, we are neither controlled by it nor inclined to follow it under these particular circumstances.

To our way of thinking, in a post-sale income situation such as we have before us here, the buyer should be held taxable when he controls the property, earns future income from it by his own efforts and then uses such income to pay for his purchase.

Alternative to his "reservation of an interest" position, petitioner contends that he acted as a trustee for Walker in receiving the commissions. Paragraph 2 of the agreement between petitioner, Walker, and Standard Accident Insurance Company provides that "Hibler agrees that in receiving the renewal commissions he will act as trustee for Walker to the extent of fifty percent (50%) thereof, and will remit Walker's share as promptly as possible to Standard * * *." Petitioner then cites Texas statutes and cases to show that when an express trust is created the one who receives income in his capacity as trustee for another is not taxes on such income. We agree with these propositions. However, in view of what we have said above, the petitioner, not Walker, earned the commissions and the amounts later paid to Walker represented payment on the purchase price of the expiration lists. As such, the amounts paid were capital expenditures and, therefore, not deductible. *Vermont Transit Co., supra* at p. 1045. Petitioner was only obligated by the sales agreement to pay over to Walker a percentage of commission income earned and received by petitioner on the renewals from Walker's former customers. He was not Walker's trustee or agent in earning such income.

Accordingly, we hold for the respondent, but to reflect the concessions made by the parties in paragraph 5 of the stipulation of facts and the conclusions reached herein with respect to the disputed issues,

Decision will be entered under Rule 50.

CERTIFICATE OF SERVICE

The undersigned attorney for petitioners has on this 5th day of January, 1968, mailed (by depositing same in the United States mail, with air mail postage prepaid) three copies of the foregoing petition addressed to Solicitor General, Department of Justice, Washington, D. C. 20530 and three such copies addressed to Honorable Mitchell Rogovin, Assistant Attorney General, Tax Division, United States Department of Justice, Washington, D. C. 20530.

Bob Huff

Bob Huff

In the Supreme Court of the United States

OCTOBER TERM, 1967

No. 956

LARRY D. HIBLER AND JUANITA HIBLER, PETITIONERS

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

MEMORANDUM FOR THE RESPONDENT IN OPPOSITION

Petitioner[1] purchased the assets of a fire, casualty and fidelity insurance agency. He paid $20,000 cash, and agreed to pay the seller 50 per cent of renewal commissions on insurance sold with the aid of the agency's list of policy expiration dates until such payments totaled $70,000. The question is whether the portions of the commissions that petitioner paid to the seller under the agreement were includible in petitioner's own gross income, as the courts below held.[2]

[1] "Petitioner" refers to Larry D. Hibler. Juanita Hibler, his wife, is a party solely because joint returns were filed.

[2] The findings of fact and opinion of the Tax Court are reported at 46 T.C. 663. The *per curiam* affirmance of the Court of Appeals is reported at 383 F. 2d 989.

288-268—68

The decisions below are correct, and there is no conflict or other ground for further review.

1. Income is taxed to the party who earns it, and this result cannot "be escaped by anticipatory arrangements and contracts however skillfully devised." *Lucas* v. *Earl,* 281 U.S. 111, 115; *Commissioner* v. *P. G. Lake, Inc.,* 356 U.S. 260. And income derived from property will be taxed to the party who owns or controls the property. *Helvering* v. *Horst,* 311 U.S. 112; cf. *Helvering* v. *Eubank,* 311 U.S. 122.

Here the seller acknowledged by contract (R. 7)[3] that he had "bargained, sold and delivered" to petitioner the agency assets, including the expiration lists. Fire, casualty and fidelity insurance coverage (unlike life insurance) does not yield automatic renewal commissions; on expiration of such policies, new coverage must be solicited and sold (R. 12). Thus the transfer of the expiration lists to petitioner was a sale of an asset in the nature of good will. Petitioner's contract required him to "use all reasonable efforts to prevent the loss of such business * * *." (R. 9–10.) The renewal commissions thereafter secured were earnings produced by petitioner's efforts and property and, as such, were includible in his income in their entirety.

The mere fact that a specified portion of the purchase price petitioner agreed to pay was to come out of the future earnings of the business and might extend over a period of time would not allow the Commissioner to treat the payments as ordinary income to the seller. *Commissioner* v. *Brown,* 380 U.S. 563.

[3] "R." refers to the record in the court of appeals.

These same facts should no more allow petitioner to exclude those payments from his income.

2. There is no merit to petitioner's contention (Pet. 4–8) that the decisions below are in conflict with *Thomas* v. *Perkins*, 301 U.S. 655, and other decisions of this Court in the mineral depletion area. Payments made as the result of a transfer of an interest in mineral-producing property, couched in the same terms as petitioner's purchase agreement, might well be ordinary income to the seller and not included in the buyer's gross income. But even on such an assumption it would not follow that the same result should obtain here.

In the depletion provisions, "Congress * * * has recognized the peculiar character of the business of extracting natural resources". *Burton-Sutton Oil Co.* v. *Commissioner*, 328 U.S. 25, 33. The depletion allowance "is based on the theory that the extraction of minerals gradually exhausts the capital investment in the mineral deposit", and "is designed to permit a recoupment of the owner's capital investment in the minerals so that when the minerals are exhausted, the owner's capital is unimpaired." *Commissioner* v. *Southwest Expl. Co.*, 350 U.S. 308, 312. The recoupment thus allowed is an incentive to the investment of risk capital in the development of mineral resources. *Weinert's Estate* v. *Commissioner*, 294 F. 2d 750, 755–756 (C.A. 5).

This Court evolved the "economic interest" concept to govern the allocation of mineral production income, and depletion deductions attributable thereto, among the participants in a mineral venture. A party

holds a depletable "economic interest" if he has acquired an interest in the mineral in place through investment and looks only to income derived from extraction for a recovery of his investment. Thus on a transfer of operating rights in minerals solely in consideration of payments dependent upon extraction, the transferor retains an "economic interest". The payments he receives are his income, subject to the depletion allowance, and are not within the gross income of the transferee. *Palmer* v. *Bender,* 287 U.S. 551; *Thomas* v. *Perkins, supra; Kirby Petroleum Co.* v. *Commissioner,* 326 U.S. 599; *Burton-Sutton Oil Co.* v. *Commissioner, supra.*

Such allocation of depletable gross income under the "economic interest" concept sets the mineral area apart from other contexts where, as in the instant case, income must be allocated in accordance with the rule that earnings are taxable to the party whose efforts or property produced them. The "economic interest" concept has not been extended to transactions outside the mineral area. See *Commissioner* v. *Brown, supra.* Moreover, the insurance expiration lists here involved are not a "wasting asset" comparable to a mineral deposit that will utimately be exhausted by production; so far as petitioner secures policy renewals with the aid of the lists, he retains the patronage of policyholders and there is no diminution of the agency's capital assets.

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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